

Investment update

2009: An extraordinary year for investment markets

In 2009, investment markets have seen some unprecedented lows and startling recoveries as the global economy started to emerge from the effects of the Global Financial Crisis (GFC). In this *Investment Update* we review some of the key events that have contributed to 2009 being an extraordinary year on the global economic stage.

January – fears of a deepening recession

Increasing concern about a deepening global recession fuelled further decline in investment markets in January 2009. The Australian share market experienced its fifth consecutive negative month as other global economies also showed signs of increasing uncertainty. In this environment, bonds continued to perform well, a trend that is a hallmark of the slow down and recession phases of the investment cycle (as covered in our September *Investment Update*). January also saw overseas governments, including the US, UK and Germany, announce further significant stimulus packages in an attempt to limit the effects of a deepening recession.

How is a recession measured?

Generally, a recession is defined as two or more consecutive quarters of negative growth in a country's Gross Domestic Product (GDP).



February – sixth consecutive month of negative returns

The Australian share market recorded its sixth consecutive month of negative returns in February. However, although returns were negative, the Australian market still outperformed (i.e. didn't fall as far as) overseas markets. Surprisingly, bonds had their first negative month in over twelve months. The Reserve Bank of Australia (RBA) cut the cash rate again, bringing a total reduction of 400 basis point (4%) since September 2008, the fastest cumulative rate reduction since the early 1990s. These rapid cuts mirrored those made by central banks in other countries. The Australian Government announced its \$42 billion stimulus package which included tax relief measures and cash payments to low income earners.

Why do interest rates go up and down?

Interest rates, which dictate the cost of borrowing (both for banks and those who borrow money from them), go up and down to help manage and stabilise inflationary and deflationary pressures on a country's economy. Generally, central banks such as the RBA lower rates to stimulate spending and the economy and raise rates to slow borrowing and spending that fuel inflation. In the general operation of a country's economy, both of these actions are required at different times as a means of maintaining economic equilibrium. Rate movements depend on a range of factors such as share market movements, the global economic situation and the country's economic health.

March – signs of recovery emerge

March delivered a stunning market turnaround after the half-year preceding it. The S&P/ASX 300 gained 8.1%, the best monthly return since December 1983 and the first positive return in six months. Despite the positive return, shares remained almost 30% lower compared to the same time in 2008. Interestingly, Australian bank shares performed well, in response to the announcement of the Public Private Investment Program (part of the US Government's rescue program for financial institutions affected by the sub-prime crisis) in the US while other Australian sectors with overseas exposure performed poorly in the face of a strong Australian dollar. Economic measures, both in Australia and overseas remained negative. This reflects the lag between share market and economic changes, as described in previous *Investment Updates*.

What's the S&P/ASX 300?

The S&P/ASX 300 is an index used to measure the overall performance of the Australian share market. The "300" in the name refers to the top 300 companies listed on the share market. Companies are included based on their current market value, which is determined as the total number of shares available on the market multiplied by the prevailing share price.

April and May – further positive signs

Despite not cutting rates in March, the RBA made another cut of 25 basis points (0.25%) in April. There was no rate change in May with the RBA revealing cautious optimism for potential growth in the Australian economy. Minutes of the RBA meeting showed that the decision to leave rates on hold was a close one. Economic data in April was mixed with retail sales dropping while the unemployment rate reached a five-year high of 5.7%. Economic news was better in May, both in Australia and overseas, with improved consumer confidence, retail sales and property-related measures.

June – return to volatility

In June, the positive market and economic momentum seen in the previous three months faltered somewhat, with a return of volatility and initial optimism turning to uncertainty over the sustainability of the recovery. In the face of this uncertainty, bonds rose, both domestically and overseas. Australian listed property performed well delivering the third consecutive monthly gain for this asset class. This mirrored a smaller positive movement for property generally in the US.

How does a recovery work?

The recovery phase of the investment cycle (like the other stages of the cycle) is rarely clear cut. The initial stages of recovery can include significant volatility and uncertainty about whether the recovery stage is sustainable. In the current year, we have seen significant signs of recovery, particularly in terms of share market performance. However uncertainty persists regarding whether the recovery will continue into 2010, with some talk of a further downturn.

July, August and September – caution amidst improving market news

Global and domestic share markets delivered strong positive returns in July, which continued into August and September, supported by positive economic news globally. The September quarter saw quiet investor confidence at the prospect of a stabilising recovery. Despite this confidence, the RBA left rates unchanged for the three-month period. The US Federal Reserve also left their target rate unchanged. France and Germany were the first European countries to report positive GDP growth since March 2008. However, at the G-20 meetings in September, constituent countries agreed to continue their stimulus programs to sustain emerging growth and to provide the opportunity for it to become well-established.

What's the G-20?

The Group of Twenty Finance Ministers and Central Bank Governors, also known as the G-20, are drawn from 19 countries plus the European Union. The G-20 acts as an economic council and a forum for co-operation within the global financial system with the goal of maintaining international financial stability. Australia is a member of the G-20, which also includes the UK, US, Argentina, Canada, China, Russia and Mexico amongst others.

October – the RBA raises rates

The big news for October was the 25 basis points (0.25%) increase in official interest rates by RBA, making Australia the first developed country in the G-20 to lift interest rates following the GFC. This rate rise was supported by strong economic data including a small drop in the unemployment rate and a further increase in consumer confidence. However, both global and domestic share markets finished the month lower, ending their seven-month run of positive returns. This change in direction was at least partly fuelled by profit taking (where investors sell shares to take advantage of rapid market rises) and mixed economic data from the US, particularly in relation to property and manufacturing.

Markets remain cautious, with variability persisting in response to company reporting and ongoing economic data. While most investors agree that the worst of the GFC is behind us and recovery is underway, how the coming twelve months will unfold remains to be seen.

Important information

The information provided in this fact sheet is general information only and does not take into account your objectives, financial situation or needs. Before making a financial decision, please assess the appropriateness of the information to your individual circumstances and consider seeking independent advice from a licensed or appropriately authorised financial adviser.

